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the statements, and consequently would not allow the defendant to introduce on the trial any evidence in support of such defence.

We are of opinion that the court erred in not holding the said statements to be sufficient, and in refusing to permit the defendant to introduce any legal and competent evidence in support of the said defence.

The judgment of the Hustings Court must, therefore, be reversed, the verdict set aside, and the case remanded for a new trial to be had in accordance with the views expressed in this opinion. *Reversed.*

BY ASSOCIATE EDITOR.—Each of the points decided in the foregoing opinion is of prime importance in the Virginia practice. The opinion is so full and so convincing that we should omit comment, save for the apprehension that by the omission we might seem to overlook, and thereby cause others to overlook, its importance.

In an editorial in 1 Va. Law Reg. 540, 542-543, Prof. Graves asserted the right of the defendant to show failure of consideration under the general issue in *assumpsit*, or in debt on an unsealed instrument, as held in the above opinion, against the contrary view maintained in 1 Barton's Law Practice (2d ed.) 491, in 4 Minor's Institutes (3d ed.), 770, 798, and in *Keckley v. Union Bank*, overruled in the principal case.

W. M. L.

KAUFMAN V. CHARLOTTESVILLE WOOLEN MILLS.*

Supreme Court of Appeals: At Richmond.

November 19, 1896.

1. DIVIDENDS—*Stock dividends—Exchange of stock reserving dividends.* A stock dividend is not, in the ordinary sense, a dividend at all; the latter being a distribution of profits to stockholders as income from their investments. And if two persons exchange stocks, each reserving to himself the dividend shortly thereafter to be declared on his original stock, and there is declared on one of the stocks a cash dividend and also a stock dividend, the cash dividend alone belongs to the original holder of the stock, and the stock dividend passes with the stock as a part thereof to the new owner.

Argued at Staunton. Decided at Richmond.

Error to a judgment of the Circuit Court of Albemarle county, rendered May 19, 1896, in an action of detinue, wherein the plaintiff in error was the plaintiff, and the defendant in error was the defendant.

Affirmed.

This was an action of detinue in the Circuit Court of Albemarle

* Reported by M. P. Burks, State Reporter.

county, brought by M. Kaufman against the Charlottesville Woolen Mills, to recover eleven shares of stock of the defendant company, of the value of fifty dollars each. The defendant filed an affidavit disclaiming all interest in the subject-matter of the suit, and averring that one William Hotopp claimed the stock sued for; that the defendant did not collude with him, and was ready and willing to abide the judgment of the court in the premises. A rule was made on Hotopp to appear and state the nature of his claim and maintain or relinquish it, and he appeared in answer thereto, stated the nature of his claim and asked to be substituted as defendant in the suit, which was accordingly done. And thereupon an issue was made up to test the question of the ownership of the stock in controversy. Neither party requiring a jury, the court heard the evidence and gave judgment in favor of the defendant, Hotopp, and to this judgment this writ of error was awarded.

Duke & Duke, for the plaintiff in error.

George Perkins, for the defendant in error.

HARRISON, J., delivered the opinion of the court.

This controversy grows out of an exchange of stock reserving dividends.

On the 3d of January, 1896, William Hotopp sold to M. Kaufman thirty shares of the capital stock of the Monticello Wine Company, par value \$100 per share, for forty shares of the capital stock of the Charlottesville Woolen Mills Company, par value \$50 per share, it being understood and agreed between the parties that Hotopp was to receive whatever dividend was declared on the stock of the Monticello Wine Company for January, 1896, and Kaufman was to receive whatever dividend was declared on the stock of the Charlottesville Woolen Mills Company for January, 1896. Each received from the other the scrip representing the stock purchased in the exchange, and the stock was duly transferred to the parties on the books of the companies.

On the 14th day of January, 1896, the Charlottesville Woolen Mills Company held its regular annual stockholders' meeting and declared a cash dividend of ten *per cent.*, and there being an accumulated surplus in the treasury, and the stockholders deeming it expedient, the following resolution was unanimously adopted: "*Resolved*, That the capital stock of said company, both common and preferred, be increased to a total sum of \$200,000, said increase to be made by capitalizing so much of the surplus of this company as will be sufficient to

accomplish the above purpose, and issuing therefor common stock of the company pro rata among the present holders of both common and preferred stock according to their respective holdings." In pursuance of this resolution the capital stock of the company was increased twenty-seven *per cent.*, and new certificates issued to the stockholders in proportion to the interest of each. Hotopp received the dividend reserved by him on the Wine Company stock, and Kaufman received the ten *per cent.* cash dividend which was distributed to the stockholders on the stock of the Woolen Mills Company. Kaufman, however, claims that, under his contract, he is also entitled to the twenty-seven *per cent.* surplus earnings in the treasury which was capitalized by the company; that inasmuch as the cash was in the treasury representing this twenty-seven *per cent.*, and could have been distributed as a dividend to the stockholders, therefore the stock dividend of twenty-seven *per cent.* represented profits of the company, and constituted part of the dividend to which he was entitled under his contract. Hotopp disputes this claim, and contends that the stock dividend did not pass; that all Kaufman was entitled to under the contract was the cash dividend of ten *per cent.* declared by the company, which was paid to him.

A stock dividend is not, in the ordinary sense, a dividend, the latter being a distribution of profits to stockholders as income from their investment. A stock dividend is merely an increase in the number of shares, the increased number representing exactly the same property that was represented by the smaller number of shares. The corporate property remains the same after the stock is increased as before, and the interest of each stockholder in the corporate property is also unchanged. He merely holds a new representative or evidence of that interest. Kaufman sold and Hotopp bought the interest of the former in the corporate property of the Woolen Mills Company, represented by a certificate for forty shares. Hotopp, after the shares were increased, owned no greater interest in the corporate property than he bought from Kaufman. The same interest after the increase was represented by a certificate for fifty-one shares instead of forty.

Corporate earnings are, until distributed by the company, part of the corporate property. The stockholder has an interest in such earnings, as he has in all the other corporate property, in proportion to his stock, but he is not entitled to the control or use of the same, except such portion thereof as the corporation, acting in good faith, may separate from the corporate property and distribute to the stockholders as dividend or income.

The accumulated profits of a corporation belong to the company, and acting in good faith, and for the best interest of all concerned, the corporation may capitalize the surplus; or it may invest it in its work and plant so as to secure and increase the permanent value of its property; or it may reserve part of the earnings of a prosperous year to make up for a possible lack of profits in future years; or it may distribute its earnings at once to its stockholders as income.

Which of these courses is to be pursued must be determined by the directors, with due regard to the condition of the company's property and affairs as a whole; and except in case of fraud and bad faith on their part, their discretion in this respect cannot be controlled by the courts. *Gibbons v. Mahon*, 136 U. S. 549. The case cited is analogous to that at bar, being a controversy between a life tenant and remainderman, the former claiming the right to enjoy as income a stock dividend declared from the accumulated earnings of the company, but the court, after reviewing the authorities, both English and American, reaches the conclusion that the new shares issued in pursuance of the stock dividend must be treated as capital, the income therefrom, alone, being payable to the life tenant.

In the case at bar it is clear on reason and authority, that the proper construction of the contract between the parties is that Kaufman retained to himself whatever dividend was declared in January, 1896, as the ordinary and usual fruit of the investment he was parting with. This he received when the cash dividend of ten *per cent.* declared for the stockholders was paid to him.

The stock dividend of twenty-seven *per cent.* represented part of the corporate property sold to Hotopp, in which Kaufman reserved no interest and was therefore not entitled to the whole or any part thereof.

The judgment of the court below is correct and must be affirmed.

BY ASSOCIATE EDITOR.—Probably in no question of corporation law are the equities more nicely balanced, or, as a consequence, has judicial opinion been more at variance than in that of the right to stock dividends, where one person is entitled to the corpus of the shares and another to the profits.

Clearly as between the corporation on the one side, and the persons whose several interests constitute the shares of stock, on the other, a stock dividend is not a dividend at all, but a permanent increase of the capital. Judge Thompson defines a dividend as "that portion of the profits and surplus funds of the corporation which has been actually set apart by a valid resolution of the board of directors, or by the shareholders at a corporate meeting, for distribution among the shareholders, according to their respective interests, in such a sense as to become segregated from the property of the corporation, and to become the property of the

shareholders distributively.”—2 Thompson on Corporations, sec. 2126. The prime object of a stock dividend, honestly declared, is to enable the corporation to permanently convert profits, otherwise proper for distribution, into permanent capital for corporate uses, and to withdraw such profits beyond the reach of separate shareholders. Whether such profits shall be distributed or not being a matter solely within the discretion of the corporation, if this discretion be properly exercised, the shareholders cannot complain that the profits are retained for the uses of the company. So that in the principal case, it would seem that the company, in effect, distributed ten *per centum* of the profits as a dividend, and added the rest to the permanent capital,—the new certificates issued being, as the court says, a mere change in the evidence of the shareholder’s interest in the capital stock. The identical question whether the term “dividend,” as used in the contract in the principal case, includes a stock dividend, does not seem to have before arisen. But the books abound in cases involving the conflicting claims to stock dividends as between life-tenants and remaindermen, where corporate shares are held in trust, the “income” or “profits” to be paid to the one and the corpus to belong to the other. The principal case, while not identical with these, seems to be fairly analogous.

The view adopted by the court in this case is maintained not only by the Supreme Court of the United States, in the case cited in the foregoing opinion, but is distinctively known as the “Massachusetts doctrine,” in which State it has received unqualified approval: *Minot v. Paine*, 99 Mass. 101; *Daland v. Williams*, 101 Mass. 571; *Rand v. Hubbell*, 115 Mass. 461 (15 Am. Rep. 121.) This is also substantially the English view: *Re Barton’s Trust*, L. R. 5 Eq. 238.

The other view, viz., that stock dividends partake of the nature of cash dividends, so far as concerns the conflicting claims of the owner of the corpus and the owner of the profits, has much reason and a strong array of authority to support it. This view is known as the “Pennsylvania rule.” The courts which adopt this rule argue that when a dividend is declared, it is presumptively a dividend, not out of its capital which the corporation has ordinarily no right to diminish by distribution, but out of profits. And as a stock dividend is but another form adopted by the corporation of distributing these profits amongst the shareholders, a court of justice should disregard the form, and deal with the substance; and hence should treat such stock dividends, as between life-tenant and remainderman, precisely as if they were payable in cash. Mr. Morawetz lends the weight of his sanction to this doctrine: “While the payment of a stock dividend is not an actual distribution of the profits, it does materially affect the rights of the shareholders in respect of the accumulated profits. The effect of a stock dividend is to capitalize the accumulated profits. The profits on account of which a stock dividend is declared can never afterwards be distributed among the stockholders as dividends, and after the new shares have been issued, the right of the corporation to pay further dividends, and the right of the shareholders to demand them, must be considered with reference to the increased nominal capital. The payment of a stock dividend is not merely an increase of the nominal amount of the shares, leaving the rights of the shareholders unchanged. In substance and effect, it amounts to a distribution of profits among the shareholders in cash, and a subsequent purchase of new shares in the company with the sums distributed.” 1 Morawetz on Corporations (2d Ed.) 468. Judge Thompson criticises the Mas-

sachusetts rule as one of "mere convenience and not a rule of justice." "It loses sight," he continues, "of the real question under consideration, what is *capital of the estate* disposed of by the will, and not what is capital of the corporation; and it goes entirely beyond tenable ground where it allows this question to be determined, not by the judicial courts upon a view of the real substance of the case, but by a board of directors—that is by a committee of persons, entirely foreign to the will, in passing a resolution declaring a dividend. A testator disposes of his estate upon a trust that the income shall go to his widow and the capital to his children. The estate is invested in the shares of a railway company. The railway company, instead of declaring cash dividends, declares stock dividends; and thus by the mere will of its board of directors, exerted to serve the interests of the corporation which they represent, and having no reference whatever to the carrying out of the trust of the will of the decedent, both the corpus and its income are saved for the children while the widow is allowed to starve": 2 Thompson on Corporations, sec. 2222. The same author thus expresses what he considers the proper view: "These considerations show that instead of attempting to lay down a hard and fast rule on the subject, which will be applicable to all cases—and herein lies the chief mistake which the courts have made in dealing with it—it should be determined upon the consideration of the *actual nature of the dividend* in each particular case. The fact that it may be inconvenient to make this determination in many cases is no reason why the courts should recoil from it, since in most cases justice imperatively demands that it should be done. In making this determination, the courts should constantly keep in view the difference between a stock dividend based upon the actual growth and increase in value of the corporate plant and business, and such a dividend based upon the cash earnings or income of the business, which the corporation may have elected to retain and use in the betterment of its property or in the increase of its business facilities." *Ib.*, sec. 2192. In other words, if the stock dividend is based upon the growth and increase in value of the corporate plant and business, it is a part of the corpus and should belong to the remainderman; if based upon the cash earnings or income of the business it is, in fact, a dividend of profits and should belong to the life tenant.

The subject of the respective rights of life-tenant and remainderman in stock dividends is discussed in a valuable note to *Gibbons v. Mahon*, in 54 Am. Rep. 262, 264-269; see also a learned article by Guy C. H. Corliss, in 33 Albany Law Journal, 427. A full collection of authorities on the right to dividends generally will be found in note to *Goodwin v. Hardy* (Me.), 99 Am. Dec. 758, 761-765. See, also, 19 Am. Law Rev. 579.

It will be observed that the action in the principal case was *detinue*. No question seems to have been made as to its propriety. Clearly enough, such action is proper to recover a certificate of shares already issued—that is to recover the paper on which the certificate is written—but where the shares have not been issued, it would seem that *detinue*, the purpose of which is to recover a specific, tangible chattel, could not be maintained. If a corporation may thus be compelled to issue shares, there is no reason why it might not, by the same action, be compelled to execute and deliver a deed. In such cases, upon judgment for the plaintiff, we apprehend that the sheriff would find some difficulty in executing the mandate of the writ of possession! See 4 Minor's Inst. (3d ed.), 429, 537-8. W. M. L.